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PRACTICE PROBLEMS

1 Benchmarks for minimally acceptable behaviors of community members are:
  A a code of ethics.
  B laws and regulations.
  C standards of conduct.

2 Specialized knowledge and skills, a commitment to serve others, and a shared code of ethics *best* characterize a(n):
  A vocation.
  B profession.
  C occupation.

3 Which of the following *best* identifies an internal trait that may lead to poor ethical decision making?
  A Overconfidence
  B Loyalty to employer
  C Promise of money or prestige

4 Situational influences in decision making will *most likely* be minimized if:
  A strong compliance programs are in place.
  B longer-term consequences are considered.
  C individuals believe they are truthful and honest.

5 Decision makers who use a compliance approach are *most likely* to:
  A avoid situational influences.
  B oversimplify decision making.
  C consider more factors than when using an ethical decision-making approach.

6 When unethical behavior erodes trust in an investment firm, that firm is *more likely* to experience:
  A lower revenues only.
  B higher expenses only.
  C lower revenues and higher expenses.

7 Which is an example of an activity that may be legal but that CFA Institute considers unethical?
  A Making legally required disclosures in marketing materials
  B Trading while in possession of material nonpublic information
  C Disclosure by an employee of his or her own company's dishonest activity

8 An ethical decision-making framework will *most likely*:
  A include a pre-determined, uniform sequence.
  B focus exclusively on confirmable facts and relationships.
  C help avoid a decision that has unanticipated ethical consequences.

9 High ethical standards are distinguishing features of which of the following bodies?
  A Craft guilds

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B Trade bodies

C Professional bodies

10 Fiduciary duty is a standard *most likely* to be upheld by members of a(n):

A employer.

B profession.

C not-for-profit body.

11 To maintain trust, the investment management profession must be interdependent with:

A regulators.

B employers.

C investment firms.

12 When an ethical dilemma occurs, an investment professional should *most likely* first raise the issue with a:

A mentor outside the firm.

B professional body's hotline.

C senior individual in the firm.

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SOLUTIONS

1 C is correct. Standards of conduct are applied to specific communities or societal groups and identify specific behaviors required of community members. These standards of conduct serve as benchmarks for the minimally acceptable behavior of community members. Codes of ethics serve as a general guide for how community members should act; they communicate the organization's values and overall expectations regarding member behavior, but they do not identify specific behaviors required of community members. Laws and regulations are rules of conduct defined by governments and related entities about obligatory and forbidden conduct broadly applicable for individuals and entities under their jurisdiction.

2 B is correct. A profession has several characteristics that distinguish it from an occupation or vocation, such as specialized knowledge and skills, service to others, and a code of ethics shared by its members. A profession is the ultimate evolution of an occupation, resulting from excellence in practice, a mastery mindest, and expected adherence to a code of ethics and standards of practice.

3 A is correct. An overconfidence bias can lead individuals to put too much importance on internal traits and intrinsic motivations, such as their own perceptions of personal honesty, that can lead to faulty decision making. Loyalty to an employer and promise of money or prestige are situational influences that can lead to faulty decision making.

4 B is correct. Consciously considering long-term consequences will help offset situational influences. We more easily recognize and consider short-term situational influences than longer-term considerations because longer-term considerations have fewer immediate consequences than situational influences do. When decision making is too narrowly focused on short-term factors, we tend to ignore longer-term risks and consequences, and the likelihood of poor ethical decision making increases. A strong compliance policy is a good first step toward developing an ethical culture; a focus on rules adherence may not be sufficient. Emphasis on compliance may not encourage decision makers to consider the larger picture and can oversimplify decision making. Taken to the extreme, a strong compliance culture can become another situational influence that blinds employees to other important considerations. An overconfidence bias can place too much importance on internal traits and intrinsic motivations, such as "I'm honest and would not lie," even though studies have shown that internal traits are generally not the main determinant of whether or not someone will behave ethically in a given situation.

5 B is correct. A compliance approach can oversimplify decision making and may not encourage decision makers to consider the larger picture. A strong compliance culture may be a good start in developing an ethical culture but can become another situational influence that may result in employees failing to consider other important factors.

6 C is correct. Unethical behavior ultimately harms investment firms. Clients are not attracted if they suspect unethical behavior, leading to less business and lower revenues. Investment firms may also experience higher relative costs because regulators are more likely to have cause to initiate costly investigations.

7 B is correct. The investment industry has examples of conduct that may be legal but that CFA Institute considers unethical. Trading while in possession of material nonpublic information is not prohibited by law worldwide and can, therefore, be legal, but CFA Institute considers such trading unethical.

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8 C is correct. Using an ethical decision-making framework consistently will help you develop sound judgment and decision-making skills and avoid making decisions that have unanticipated ethical consequences. The decision-making process is often iterative, and the decision maker may move between phases of the framework. A decision maker should consider more than confirmable facts and relationships; for example, the decision maker should consider situational influences and personal biases.

9 C is correct. High ethical standards distinguish professions from the craft guilds or trade bodies. Unlike trade bodies, professional bodies also typically have a mission to serve society and enforce professional conduct rules for practitioners.

10 B is correct. Fiduciary duty is an obligation to deliver a high standard of care when acting for the benefit of another party. Professionals must act in the best interest of the client, exercising a reasonable level of care, skill, and diligence. Other entities—including employers, regulators, trade associations, and not-for-profit bodies—may also support an industry but are not the same as professional bodies. Unlike professions, these other entities generally do not exist to set and maintain professional standards.

11 C is correct. The investment management profession and investment firms must be interdependent to maintain trust. Employers and regulators have their own standards and practices, which may differ from regulations and standards set by professional bodies.

12 C is correct. When a dilemma occurs, raising an issue internally with a senior employee is often a good starting place and creates an opportunity for an independent internal review. Protecting the client and the firm may take priority over the position of an individual professional raising a concern.

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PRACTICE PROBLEMS

1 The Standards of Practice Handbook provides guidance:

A regarding the penalties incurred as a result of ethical violations.

B to which all CFA Institute members and candidates must adhere.

C through explanatory material and examples intended to be all inclusive.

2 Which of the following statements *best* describes an aspect of the Professional Conduct Program process?

A Inquiries are not initiated in response to information provided by the media.

B Investigations result in Disciplinary Review Committee panels for each case.

C Investigations may include requesting a written explanation from the member or candidate.

3 A current Code of Ethics principle reads in full, "Promote the integrity:

A and viability of the global capital markets."

B of and uphold the rules governing capital markets."

C and viability of the global capital markets for the ultimate benefit of society."

4 As stated in the revised 11th edition, the Standards of Professional Conduct:

A require supervisors to focus on the detection and prevention of violations.

B adopt separate ethical considerations for programs such as CIPM and Investment Foundations.

C address the risks and limitations of recommendations being made to clients.

5 According to the Code of Ethics, members of CFA Institute and candidates for the CFA designation must:

A maintain their professional competence to exercise independent professional judgment.

B place the integrity of the investment profession and the interests of clients above their own personal interests.

C practice in a professional and ethical manner with the public, clients, and others in the global capital markets.

6 Which of the following statements *best* describes an aspect of the Standards of Professional Conduct? Members and candidates are required to:

A ensure any portfolio mandate followed is fair, accurate, and complete.

B promptly disclose changes that might materially affect investment processes.

C have a reasonable and adequate basis for decisions about client confidentiality.

7 Which of the following categories completely represents an ethical principle of CFA Institute as outlined in the *Standards of Practice Handbook*?

A Individual professionalism

B Responsibilities to clients and employers

C Ethics involved in investment analysis and recommendations

8 A CFA Institute member would violate the standard for material nonpublic information by:

A conducting price distortion practices.

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B inappropriately causing others to act.

C inadequately maintaining investment records.

9 According to the Duties to Clients standard, suitability requires members and candidates in an advisory relationship with a client to:

A place their clients' interests before their own interests.

B consider investments in the context of the client's total portfolio.

C not knowingly make misrepresentations relating to recommendations.

10 As part of the Duties to Clients standard, members and candidates must:

A document client financial constraints after an initial investment action.

B maintain an equal balance of interests owed to their clients and employers.

C deal fairly and objectively with all clients when engaging in professional activities.

11 The Duties to Employers standard states that members and candidates must not:

A accept any gifts that might compromise their independence and objectivity.

B deprive their employer of their skills and abilities as related to their employment.

C accept compensation competing with their employer's interest and with the written consent of all parties involved.

12 The Investment Analysis, Recommendations, and Actions standard states that members and candidates must:

A find an investment suitable for their client before making a recommendation.

B make reasonable efforts to ensure that performance presentation is fair, accurate, and complete.

C distinguish between fact and opinion in the presentation of investment analysis and recommendations.

13 Based on the Conflicts of Interest standard, members and candidates must:

A disclose, as required by law, those conflicts interfering with their professional duties.

B disclose, as appropriate, any benefit paid to others for the recommendation of products.

C seek employer approval before prioritizing their investment transactions over those clients.

14 The Responsibilities as a CFA Institute Member or CFA Candidate Standard explicitly states a requirement regarding:

A loyalty.

B responsibility of supervisors.

C reference to the CFA Program.

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SOLUTIONS

1 B is correct. The *Standards of Practice Handbook* provides guidance to which CFA Institute members and candidates are required to adhere.

A is incorrect because the *Handbook* provides guidance in understanding the interconnectedness of the aspirational and practical principles (not regarding penalties for violations) of the Code of Ethics and Standards of Conduct.

C is incorrect because although the *Standards of Practice Handbook* provides hypothetical but factual situations, the explanatory material and examples are not intended to be all inclusive.

2 C is correct. When an inquiry is initiated, the Professional Conduct staff conducts an investigation that may include requesting a written explanation from the member or candidate.

A is incorrect because Professional Conduct inquiries can be initiated in response to information provided by the media. CFA Institute staff may become aware of questionable conduct by a member or candidate through the media, regulatory notices, or another public source.

B is incorrect because although the Disciplinary Review Committee (DRC) is responsible for enforcement of the Code and Standards in conjunction with the Professional Conduct Program (PCP), only in the event that a member or candidate does not accept the charges and proposed sanction is the matter referred to a panel composed of DRC members.

3 C is correct. One of the principles in the Code of Ethics was updated to reflect the role that the capital markets have in society as a whole.

A is incorrect because it is incomplete, missing the additional language to reflect the role that the capital markets have in society as a whole.

B is incorrect because this is the old principle as written in the Code of Ethics, which was recently updated to reflect the role of the capital markets in society as a whole.

4 C is correct. Given the constant development of new and exotic financial instruments and strategies, the standard regarding communicating with clients now includes an implicit requirement to discuss the risks and limitations of recommendations being made to clients.

A is incorrect because the updated standard for members and candidates with supervision or authority over others within their firms stresses broader compliance expectations, which include the detection and prevention aspects of the original version that was the prior focus.

B is incorrect because the updated standard not only maintains the integrity of the CFA Program but also expands the same (not separate) ethical considerations when members or candidates participate in such programs as the CIPM Program and the Investment Foundations Certificate.

5 B is correct. Members of CFA Institute and candidates for the CFA designation must place the integrity of the investment profession and the interests of clients above their own personal interests.

A is incorrect because members of CFA Institute and candidates for the CFA designation must maintain and improve their professional competence and strive to maintain and improve the competence of other investment professionals. The exercise of independent professional judgment is associated with using reasonable care.

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C is incorrect because members of CFA Institute and candidates for the CFA designation must practice and encourage others to practice in a professional and ethical manner that will reflect credibly on themselves and the profession. Members are supposed to act with integrity, competence, diligence, and respect and in an ethical manner with the public, clients, and other market participants.

6 B is correct. The current Standards of Professional Conduct requires members and candidates to promptly disclose any changes that might materially affect investment processes.

A is incorrect because under Standard III.C.2 Suitability, when members and candidates are responsible for managing a portfolio according to a specific mandate, they must take only investment actions that are consistent with the stated objectives of the portfolio. The "fair, accurate, and complete" criterion relates to the Standard III D Performance Presentation.

C is incorrect because under Standard III.E.1, 2, 3 Preservation of Confidentiality, members and candidates must keep information about current clients confidential unless the information concerns illegal activities on the part of the client, disclosure is required by law, or the client permits disclosure. No decisions on confidentiality are required, with the "reasonable and adequate basis" criterion related to Standard V.A.2 Diligence and Reasonable Basis.

7 A is correct. Within the *Standards of Practice Handbook*, CFA Institute addresses ethical principles for the profession, including individual professionalism; responsibilities to capital markets, clients, and employers; ethics involved in investment analysis; recommendations, and actions; and possible conflicts of interest.

B is incorrect because it does not include responsibilities to capital markets.

C is incorrect because the ethical principles not only address ethics involved in investment analysis and recommendations but also address actions.

8 B is correct. Under Standard II.A Material Nonpublic Information, members having material nonpublic information that could affect the value of an investment must not cause others to act on the information.

A is incorrect because price distortion is mentioned in the Standard II.B Market Manipulation, not Standard II.A Material Nonpublic Information.

C is incorrect because the maintenance of appropriate records to support investment analyses is noted in Standard V.C Record Retention, not Standard II.A Material Nonpublic Information.

9 B is correct. Standard III.C.1c Suitability states that when members and candidates are in an advisory relationship with a client, they must judge the suitability of investments in the context of the client's total portfolio.

A is incorrect because this is a requirement addressed under Standard III.A Loyalty, Prudence, and Care, not Standard III.C.1c Suitability.

C is incorrect because this is a requirement addressed under Standard I.C Misrepresentation, not Standard III.C.1c Suitability.

10 C is correct. Under the III.B Fair Dealing section of the Duty to Clients standard, members and candidates must deal fairly and objectively with all clients when providing investment analysis, making investment recommendations, taking investment action, or engaging in other professional activities.

A is incorrect because under Standard III.C.1a Suitability, a section of Duties to Clients, members and candidates in an advisory relationship must make a reasonable inquiry into a client's financial constraints prior to (not after) taking investment action and must reassess and update this regularly.

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B is incorrect because under Standard III.A Loyalty, Prudence, and Care, members and candidates must act for the benefit of their clients and place their clients' interests before (not maintain an equal balance with) their employer's or their own interests.

11 B is correct. The IV.A Loyalty section of the Duties to Employers standard states that members and candidates cannot deprive their employer of the advantage of their skills and abilities in matters related to their employment.

A is incorrect because accepting gifts that might compromise a member or candidate's independence and objectivity is addressed by Standard I.B Independence and Objectivity, a section of Professionalism, not under Standard IV Duties to Employers.

C is incorrect because IV.B Additional Compensation Arrangements, part of the Duties to Employers standard, permits members and candidates to accept compensation that competes with their employer's interest if they obtain written consent from all parties involved.

12 C is correct. The V.B.4 Communications with Clients and Prospective Clients section of the Investment Analysis, Recommendations, and Actions standard states that members and candidates must distinguish between fact and opinion in the presentation of investment analysis and recommendations.

A is incorrect because this standard is discussed in the III.C.1b Suitability section of the Duties to Clients standard.

B is incorrect because performance presentation is discussed in the III.D Performance Presentation section of the Duties to Clients standard.

13 B is correct. The VI.C Referral Fees section of the Conflicts of Interest standard requires members and candidates to disclose to their employer, clients, and prospective clients, as appropriate, any compensation, consideration, or benefit received from or paid to others for the recommendation of products or services.

A is incorrect because the VI.A Disclosure of Conflicts section of the Conflicts of Interest standard requires members and candidates to make full and fair disclosure of all matters (not limited to legal requirements) that could reasonably be expected to impair their independence and objectivity or interfere with respective duties to their clients, prospective clients, and employer.

C is incorrect because the VI.B Priority of Transactions section of the Conflicts of Interest standard requires members and candidates to give priority to investment transactions for clients and employers versus those in which a member or candidate is the beneficial owner. This requirement is not waived by an employer's approval.

14 C is correct. The VII.B Reference to CFA Institute, the CFA Designation, and the CFA Program section of the Responsibilities as a CFA Institute Member or CFA Candidate standard explicitly states the appropriate manner to make reference to CFA Institute, CFA Institute membership, the CFA designation, or candidacy in the CFA Program.

A is incorrect because Standard VII Responsibilities as a CFA Institute Member or CFA Candidate standard does not refer to loyalty. Loyalty is addressed in two other standards, Standard III.A Loyalty, Prudence, and Care and Standard IV.A Loyalty.

B is incorrect because Standard VII Responsibilities as a CFA Institute Member or CFA Candidate standard does not refer to the responsibility of supervisors. The responsibility of supervisors is addressed in Standard IV.C Responsibility of Supervisors.

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PRACTICE PROBLEMS

Unless otherwise stated in the question, all individuals in the following questions are CFA Institute members or candidates in the CFA Program and, therefore, are subject to the CFA Institute Code of Ethics and Standards of Professional Conduct.

1 Smith, a research analyst with a brokerage firm, decides to change his recommendation for the common stock of Green Company, Inc., from a "buy" to a "sell." He mails this change in investment advice to all the firm's clients on Wednesday. The day after the mailing, a client calls with a buy order for 500 shares of Green Company. In this circumstance, Smith should:

A Accept the order.

B Advise the customer of the change in recommendation before accepting the order.

C Not accept the order because it is contrary to the firm's recommendation.

2 Which statement about a manager's use of client brokerage commissions violates the Code and Standards?

A A client may direct a manager to use that client's brokerage commissions to purchase goods and services for that client.

B Client brokerage commissions should be used to benefit the client and should be commensurate with the value of the brokerage and research services received.

C Client brokerage commissions may be directed to pay for the investment manager's operating expenses.

3 Jamison is a junior research analyst with Howard & Howard, a brokerage and investment banking firm. Howard & Howard's mergers and acquisitions department has represented the Britland Company in all of its acquisitions for the past 20 years. Two of Howard & Howard's senior officers are directors of various Britland subsidiaries. Jamison has been asked to write a research report on Britland. What is the best course of action for her to follow?

A Jamison may write the report but must refrain from expressing any opinions because of the special relationships between the two companies.

B Jamison should not write the report because the two Howard & Howard officers serve as directors for subsidiaries of Britland.

C Jamison may write the report if she discloses the special relationships with the company in the report.

4 Which of the following statements clearly *conflicts* with the recommended procedures for compliance presented in the CFA Institute *Standards of Practice Handbook*?

A Firms should disclose to clients the personal investing policies and procedures established for their employees.

B Prior approval must be obtained for the personal investment transactions of all employees.

C For confidentiality reasons, personal transactions and holdings should not be reported to employers unless mandated by regulatory organizations.

5 Bronson provides investment advice to the board of trustees of a private university endowment fund. The trustees have provided Bronson with the fund's financial information, including planned expenditures. Bronson receives a

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phone call on Friday afternoon from Murdock, a prominent alumnus, requesting that Bronson fax him comprehensive financial information about the fund. According to Murdock, he has a potential contributor but needs the information that day to close the deal and cannot contact any of the trustees. Based on the CFA Institute Standards, Bronson should:

A Send Murdock the information because disclosure would benefit the client.

B Not send Murdock the information to preserve confidentiality.

C Send Murdock the information, provided Bronson promptly notifies the trustees.

6 Willier is the research analyst responsible for following Company X. All the information he has accumulated and documented suggests that the outlook for the company's new products is poor, so the stock should be rated a weak "hold." During lunch, however, Willier overhears a financial analyst from another firm whom he respects offer opinions that conflict with Willier's forecasts and expectations. Upon returning to his office, Willier releases a strong "buy" recommendation to the public. Willier:

A Violated the Standards by failing to distinguish between facts and opinions in his recommendation.

B Violated the Standards because he did not have a reasonable and adequate basis for his recommendation.

C Was in full compliance with the Standards.

7 An investment management firm has been hired by ETV Corporation to work on an additional public offering for the company. The firm's brokerage unit now has a "sell" recommendation on ETV, but the head of the investment banking department has asked the head of the brokerage unit to change the recommendation from "sell" to "buy." According to the Standards, the head of the brokerage unit would be permitted to:

A Increase the recommendation by no more than one increment (in this case, to a "hold" recommendation).

B Place the company on a restricted list and give only factual information about the company.

C Assign a new analyst to decide if the stock deserves a higher rating.

8 Albert and Tye, who recently started their own investment advisory business, have registered to take the Level III CFA examination. Albert's business card reads, "Judy Albert, CFA Level II." Tye has not put anything about the CFA designation on his business card, but promotional material that he designed for the business describes the CFA requirements and indicates that Tye participates in the CFA Program and has completed Levels I and II. According to the Standards:

A Albert has violated the Standards, but Tye has not.

B Tye has violated the Standards, but Albert has not.

C Both Albert and Tye have violated the Standards.

9 Scott works for a regional brokerage firm. He estimates that Walkton Industries will increase its dividend by US$1.50 a share during the next year. He realizes that this increase is contingent on pending legislation that would, if enacted, give Walkton a substantial tax break. The US representative for Walkton's home district has told Scott that, although she is lobbying hard for the bill and prospects for its passage are favorable, concern of the US Congress over the federal deficit could cause the tax bill to be voted down. Walkton Industries has not made any statements about a change in dividend policy. Scott writes in his

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research report, "We expect Walkton's stock price to rise by at least US$8.00 a share by the end of the year because the dividend will increase by US$1.50 a share. Investors buying the stock at the current time should expect to realize a total return of at least 15% on the stock." According to the Standards:

A Scott violated the Standards because he used material inside information.

B Scott violated the Standards because he failed to separate opinion from fact.

C Scott violated the Standards by basing his research on uncertain predictions of future government action.

10 Which one of the following actions will help to ensure the fair treatment of brokerage firm clients when a new investment recommendation is made?

A Informing all people in the firm in advance that a recommendation is to be disseminated.

B Distributing recommendations to institutional clients prior to individual accounts.

C Minimizing the time between the decision and the dissemination of a recommendation.

11 The mosaic theory holds that an analyst:

A Violates the Code and Standards if the analyst fails to have knowledge of and comply with applicable laws.

B Can use material public information and nonmaterial nonpublic information in the analyst's analysis.

C Should use all available and relevant information in support of an investment recommendation.

12 Jurgen is a portfolio manager. One of her firm's clients has told Jurgen that he will compensate her beyond the compensation provided by her firm on the basis of the capital appreciation of his portfolio each year. Jurgen should:

A Turn down the additional compensation because it will result in conflicts with the interests of other clients' accounts.

B Turn down the additional compensation because it will create undue pressure on her to achieve strong short-term performance.

C Obtain permission from her employer prior to accepting the compensation arrangement.

13 One of the discretionary accounts managed by Farnsworth is the Jones Corporation employee profit-sharing plan. Jones, the company president, recently asked Farnsworth to vote the shares in the profit-sharing plan in favor of the slate of directors nominated by Jones Corporation and against the directors sponsored by a dissident stockholder group. Farnsworth does not want to lose this account because he directs all the account's trades to a brokerage firm that provides Farnsworth with useful information about tax-free investments. Although this information is not of value in managing the Jones Corporation account, it does help in managing several other accounts. The brokerage firm providing this information also offers the lowest commissions for trades and provides best execution. Farnsworth investigates the director issue, concludes that the management-nominated slate is better for the long-run performance of the company than the dissident group's slate, and votes accordingly. Farnsworth:

A Violated the Standards in voting the shares in the manner requested by Jones but not in directing trades to the brokerage firm.

B Did not violate the Standards in voting the shares in the manner requested by Jones or in directing trades to the brokerage firm.

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C Violated the Standards in directing trades to the brokerage firm but not in voting the shares as requested by Jones.

14 Brown works for an investment counseling firm. Green, a new client of the firm, is meeting with Brown for the first time. Green used another counseling firm for financial advice for years, but she has switched her account to Brown's firm. After spending a few minutes getting acquainted, Brown explains to Green that she has discovered a highly undervalued stock that offers large potential gains. She recommends that Green purchase the stock. Brown has committed a violation of the Standards. What should she have done differently?

A Brown should have determined Green's needs, objectives, and tolerance for risk before making a recommendation of any type of security.

B Brown should have thoroughly explained the characteristics of the company to Green, including the characteristics of the industry in which the company operates.

C Brown should have explained her qualifications, including her education, training, and experience and the meaning of the CFA designation.

15 Grey recommends the purchase of a mutual fund that invests solely in long-term US Treasury bonds. He makes the following statements to his clients:

I. "The payment of the bonds is guaranteed by the US government; therefore, the default risk of the bonds is virtually zero."

II. "If you invest in the mutual fund, you will earn a 10% rate of return each year for the next several years based on historical performance of the market."

Did Grey's statements violate the CFA Institute Code and Standards?

A Neither statement violated the Code and Standards.

B Only statement I violated the Code and Standards.

C Only statement II violated the Code and Standards.

16 Anderb, a portfolio manager for XYZ Investment Management Company—a registered investment organization that advises investment firms and private accounts—was promoted to that position three years ago. Bates, her supervisor, is responsible for reviewing Anderb's portfolio account transactions and her required monthly reports of personal stock transactions. Anderb has been using Jonelli, a broker, almost exclusively for brokerage transactions for the portfolio account. For securities in which Jonelli's firm makes a market, Jonelli has been giving Anderb lower prices for personal purchases and higher prices for personal sales than Jonelli gives to Anderb's portfolio accounts and other investors. Anderb has been filing monthly reports with Bates only for those months in which she has no personal transactions, which is about every fourth month. Which of the following is *most likely* to be a violation of the Code and Standards?

A Anderb failed to disclose to her employer her personal transactions.

B Anderb owned the same securities as those of her clients.

C Bates allowed Anderb to use Jonelli as her broker for personal trades.

17 Which of the following is a correct statement of a member's or candidate's duty under the Code and Standards?

A In the absence of specific applicable law or other regulatory requirements, the Code and Standards govern the member's or candidate's actions.

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B A member or candidate is required to comply only with applicable local laws, rules, regulations, or customs, even though the Code and Standards may impose a higher degree of responsibility or a higher duty on the member or candidate.

C A member or candidate who trades securities in a securities market where no applicable local laws or stock exchange rules regulate the use of material nonpublic information may take investment action based on material nonpublic information.

18 Ward is scheduled to visit the corporate headquarters of Evans Industries. Ward expects to use the information he obtains there to complete his research report on Evans stock. Ward learns that Evans plans to pay all of Ward's expenses for the trip, including costs of meals, hotel room, and air transportation. Which of the following actions would be the *best* course for Ward to take under the Code and Standards?

A Accept the expense-paid trip and write an objective report.

B Pay for all travel expenses, including costs of meals and incidental items.

C Accept the expense-paid trip but disclose the value of the services accepted in the report.

19 Which of the following statements is *correct* under the Code and Standards?

A CFA Institute members and candidates are prohibited from undertaking independent practice in competition with their employer.

B Written consent from the employer is necessary to permit independent practice that could result in compensation or other benefits in competition with a member's or candidate's employer.

C Members and candidates are prohibited from making arrangements or preparations to go into a competitive business before terminating their relationship with their employer.

20 Smith is a financial analyst with XYZ Brokerage Firm. She is preparing a purchase recommendation on JNI Corporation. Which of the following situations is *most likely* to represent a conflict of interest for Smith that would have to be disclosed?

A Smith frequently purchases items produced by JNI.

B XYZ holds for its own account a substantial common stock position in JNI.

C Smith's brother-in-law is a supplier to JNI.

21 Michelieu tells a prospective client, "I may not have a long-term track record yet, but I'm sure that you'll be very pleased with my recommendations and service. In the three years that I've been in the business, my equity-oriented clients have averaged a total return of more than 26% a year." The statement is true, but Michelieu only has a few clients, and one of his clients took a large position in a penny stock (against Michelieu's advice) and realized a huge gain. This large return caused the average of all of Michelieu's clients to exceed 26% a year. Without this one investment, the average gain would have been 8% a year. Has Michelieu violated the Standards?

A No, because Michelieu is not promising that he can earn a 26% return in the future.

B No, because the statement is a true and accurate description of Michelieu's track record.

C Yes, because the statement misrepresents Michelieu's track record.

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22 An investment banking department of a brokerage firm often receives material nonpublic information that could have considerable value if used in advising the firm's brokerage clients. In order to conform to the Code and Standards, which one of the following is the best policy for the brokerage firm?

A Permanently prohibit both "buy" and "sell" recommendations of the stocks of clients of the investment banking department.

B Establish physical and informational barriers within the firm to prevent the exchange of information between the investment banking and brokerage operations.

C Monitor the exchange of information between the investment banking department and the brokerage operation.

23 Stewart has been hired by Goodner Industries, Inc., to manage its pension fund. Stewart's duty of loyalty, prudence, and care is owed to:

A The management of Goodner.

B The participants and beneficiaries of Goodner's pension plan.

C The shareholders of Goodner.

24 Which of the following statements is a stated purpose of disclosure in Standard VI(C)–Referral Fees?

A Disclosure will allow the client to request discounted service fees.

B Disclosure will help the client evaluate any possible partiality shown in the recommendation of services.

C Disclosure means advising a prospective client about the referral arrangement once a formal client relationship has been established.

25 Rose, a portfolio manager for a local investment advisory firm, is planning to sell a portion of his personal investment portfolio to cover the costs of his child's academic tuition. Rose wants to sell a portion of his holdings in Household Products, but his firm recently upgraded the stock to "strong buy." Which of the following describes Rose's options under the Code and Standards?

A Based on his firm's "buy" recommendation, Rose cannot sell the shares because he would be improperly prospering from the inflated recommendation.

B Rose is free to sell his personal holdings once his firm is properly informed of his intentions.

C Rose can sell his personal holdings but only when a client of the firm places an order to buy shares of Household.

26 A former hedge fund manager, Jackman, has decided to launch a new private wealth management firm. From his prior experiences, he believes the new firm needs to achieve US$1 million in assets under management in the first year. Jackman offers a $10,000 incentive to any adviser who joins his firm with the minimum of $200,000 in committed investments. Jackman places notice of the opening on several industry web portals and career search sites. Which of the following is *correct* according to the Code and Standards?

A A member or candidate is eligible for the new position and incentive if he or she can arrange for enough current clients to switch to the new firm and if the member or candidate discloses the incentive fee.

B A member or candidate may not accept employment with the new firm because Jackman's incentive offer violates the Code and Standards.

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C A member or candidate is not eligible for the new position unless he or she is currently unemployed because soliciting the clients of the member's or candidate's current employer is prohibited.

27 Carter works for Invest Today, a local asset management firm. A broker that provides Carter with proprietary research through client brokerage arrangements is offering a new trading service. The broker is offering low-fee, execution-only trades to complement its traditional full-service, execution-and-research trades. To entice Carter and other asset managers to send additional business its way, the broker will apply the commissions paid on the new service toward satisfying the brokerage commitment of the prior full-service arrangements. Carter has always been satisfied with the execution provided on the full-service trades, and the new low-fee trades are comparable to the fees of other brokers currently used for the accounts that prohibit soft dollar arrangements.

A Carter can trade for his accounts that prohibit soft dollar arrangements under the new low-fee trading scheme.

B Carter cannot use the new trading scheme because the commissions are prohibited by the soft dollar restrictions of the accounts.

C Carter should trade only through the new low-fee scheme and should increase his trading volume to meet his required commission commitment.

28 Rule has worked as a portfolio manager for a large investment management firm for the past 10 years. Rule earned his CFA charter last year and has decided to open his own investment management firm. After leaving his current employer, Rule creates some marketing material for his new firm. He states in the material, "In earning the CFA charter, a highly regarded credential in the investment management industry, I further enhanced the portfolio management skills learned during my professional career. While completing the examination process in three consecutive years, I consistently received the highest possible scores on the topics of Ethics, Alternative Investments, and Portfolio Management." Has Rule violated Standard VII(B)–Reference to CFA Institute, the CFA Designation, and the CFA Program in his marketing material?

A Rule violated Standard VII(B) in stating that he completed the exams in three consecutive years.

B Rule violated Standard VII(B) in stating that he received the highest scores in the topics of Ethics, Alternative Investments, and Portfolio Management.

C Rule did not violate Standard VII(B).

29 Stafford is a portfolio manager for a specialized real estate mutual fund. Her firm clearly describes in the fund's prospectus its soft dollar policies. Stafford decides that entering the CFA Program will enhance her investment decision-making skill and decides to use the fund's soft dollar account to pay the registration and exam fees for the CFA Program. Which of the following statements is *most likely* correct?

A Stafford did not violate the Code and Standards because the prospectus informed investors of the fund's soft dollar policies.

B Stafford violated the Code and Standards because improving her investment skills is not a reasonable use of the soft dollar account.

C Stafford violated the Code and Standards because the CFA Program does not meet the definition of research allowed to be purchased with brokerage commissions.

30 Long has been asked to be the keynote speaker at an upcoming investment conference. The event is being hosted by one of the third-party investment managers currently used by his pension fund. The manager offers to cover all

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conference and travel costs for Long and make the conference registrations free for three additional members of his investment management team. To ensure that the conference obtains the best speakers, the host firm has arranged for an exclusive golf outing for the day following the conference on a local championship-caliber course. Which of the following is *least likely* to violate Standard I(B)?

A Long may accept only the offer to have his conference-related expenses paid by the host firm.

B Long may accept the offer to have his conference-related expenses paid and may attend the exclusive golf outing at the expense of the hosting firm.

C Long may accept the entire package of incentives offered to speak at this conference.

31 Andrews, a private wealth manager, is conducting interviews for a new research analyst for his firm. One of the candidates is Wright, an analyst with a local investment bank. During the interview, while Wright is describing his analytical skills, he mentions a current merger in which his firm is acting as the adviser. Andrews has heard rumors of a possible merger between the two companies, but no releases have been made by the companies concerned. Which of the following actions by Andrews is *least likely* a violation of the Code and Standards?

A Waiting until the next day before trading on the information to allow time for it to become public.

B Notifying all investment managers in his firm of the new information so none of their clients are disadvantaged.

C Placing the securities mentioned as part of the merger on the firm's restricted trading list.

32 Pietro, president of Local Bank, has hired the bank's market maker, Vogt, to seek a merger partner. Local is currently not listed on a stock exchange and has not reported that it is seeking strategic alternatives. Vogt has discussed the possibility of a merger with several firms, but they have all decided to wait until after the next period's financial data are available. The potential buyers believe the results will be worse than the results of prior periods and will allow them to pay less for Local Bank.

Pietro wants to increase the likelihood of structuring a merger deal quickly. Which of the following actions would *most likely* be a violation of the Code and Standards?

A Pietro could instruct Local Bank to issue a press release announcing that it has retained Vogt to find a merger partner.

B Pietro could place a buy order for 2,000 shares (or four times the average weekly volume) through Vogt for his personal account.

C After confirming with Local's chief financial officer, Pietro could instruct Local to issue a press release reaffirming the firm's prior announced earnings guidance for the full fiscal year.

33 ABC Investment Management acquires a new, very large account with two concentrated positions. The firm's current policy is to add new accounts for the purpose of performance calculation after the first full month of management. Cupp is responsible for calculating the firm's performance returns. Before the end of the initial month, Cupp notices that one of the significant holdings of the new accounts is acquired by another company, causing the value of the investment to double. Because of this holding, Cupp decides to account for the new portfolio as of the date of transfer, thereby allowing ABC Investment to reap the positive impact of that month's portfolio return.

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A Cupp did not violate the Code and Standards because the GIPS standards allow composites to be updated on the date of large external cash flows.

B Cupp did not violate the Code and Standards because companies are allowed to determine when to incorporate new accounts into their composite calculation.

C Cupp violated the Code and Standards because the inclusion of the new account produces an inaccurate calculation of the monthly results according to the firm's stated policies.

34 Cannan has been working from home on weekends and occasionally saves correspondence with clients and completed work on her home computer. Because of worsening market conditions, Cannan is one of several employees released by her firm. While Cannan is looking for a new job, she uses the files she saved at home to request letters of recommendation from former clients. She also provides to prospective clients some of the reports as examples of her abilities.

A Cannan violated the Code and Standards because she did not receive permission from her former employer to keep or use the files after her employment ended.

B Cannan did not violate the Code and Standards because the files were created and saved on her own time and computer.

C Cannan violated the Code and Standards because she is prohibited from saving files on her home computer.

35 Quinn sat for the Level III CFA exam this past weekend. He updates his resume with the following statement: "In finishing the CFA Program, I improved my skills related to researching investments and managing portfolios. I will be eligible for the CFA charter upon completion of the required work experience."

A Quinn violated the Code and Standards by claiming he improved his skills through the CFA Program.

B Quinn violated the Code and Standards by incorrectly stating that he is eligible for the CFA charter.

C Quinn did not violate the Code and Standards with his resume update.

36 During a round of golf, Rodriguez, chief financial officer of Mega Retail, mentions to Hart, a local investment adviser and long-time personal friend, that Mega is having an exceptional sales quarter. Rodriguez expects the results to be almost 10% above the current estimates. The next day, Hart initiates the purchase of a large stake in the local exchange-traded retail fund for her personal account.

A Hart violated the Code and Standards by investing in the exchange-traded fund that included Mega Retail.

B Hart did not violate the Code and Standards because she did not invest directly in securities of Mega Retail.

C Rodriguez did not violate the Code and Standards because the comments made to Hart were not intended to solicit an investment in Mega Retail.

37 Park is very frustrated after taking her Level II exam. While she was studying for the exam, to supplement the curriculum provided, she ordered and used study material from a third-party provider. Park believes the additional material focused her attention on specific topic areas that were not tested while ignoring other areas. She posts the following statement on the provider's discussion board: "I am very dissatisfied with your firm's CFA Program Level II material. I found the exam extremely difficult and myself unprepared for specific questions after using your product. How could your service provide such limited

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instructional resources on the analysis of inventories and taxes when the exam had multiple questions about them? I will not recommend your products to other candidates."

A Park violated the Code and Standards by purchasing third-party review material.

B Park violated the Code and Standards by providing her opinion on the difficulty of the exam.

C Park violated the Code and Standards by providing specific information on topics tested on the exam.

38 Paper was recently terminated as one of a team of five managers of an equity fund. The fund had two value-focused managers and terminated one of them to reduce costs. In a letter sent to prospective employers, Paper presents, with written permission of the firm, the performance history of the fund to demonstrate his past success.

A Paper did not violate the Code and Standards.

B Paper violated the Code and Standards by claiming the performance of the entire fund as his own.

C Paper violated the Code and Standards by including the historical results of his prior employer.

39 Townsend was recently appointed to the board of directors of a youth golf program that is the local chapter of a national not-for-profit organization. The program is beginning a new fund-raising campaign to expand the number of annual scholarships it provides. Townsend believes many of her clients make annual donations to charity. The next week in her regular newsletter to all clients, she includes a small section discussing the fund-raising campaign and her position on the organization's board.

A Townsend did not violate the Code and Standards.

B Townsend violated the Code and Standards by soliciting donations from her clients through the newsletter.

C Townsend violated the Code and Standards by not getting approval of the organization before soliciting her clients.

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SOLUTIONS

1 The correct answer is B. This question involves Standard III(B)–Fair Dealing. Smith disseminated a change in the stock recommendation to his clients but then received a request contrary to that recommendation from a client who probably had not yet received the recommendation. Prior to executing the order, Smith should take additional steps to ensure that the customer has received the change of recommendation. Answer A is incorrect because the client placed the order prior to receiving the recommendation and, therefore, does not have the benefit of Smith's most recent recommendation. Answer C is also incorrect; simply because the client request is contrary to the firm's recommendation does not mean a member can override a direct request by a client. After Smith contacts the client to ensure that the client has received the changed recommendation, if the client still wants to place a buy order for the shares, Smith is obligated to comply with the client's directive.

2 The correct answer is C. This question involves Standard III(A)–Loyalty, Prudence, and Care and the specific topic of soft dollars or soft commissions. Answer C is the correct choice because client brokerage commissions may not be directed to pay for the investment manager's operating expenses. Answer B describes how members and candidates should determine how to use brokerage commissions—that is, if the use is in the best interests of clients and is commensurate with the value of the services provided. Answer A describes a practice that is commonly referred to as "directed brokerage." Because brokerage is an asset of the client and is used to benefit the client, not the manager, such practice does not violate a duty of loyalty to the client. Members and candidates are obligated in all situations to disclose to clients their practices in the use of client brokerage commissions.

3 The correct answer is C. This question involves Standard VI(A)–Disclosure of Conflicts. The question establishes a conflict of interest in which an analyst, Jamison, is asked to write a research report on a company that is a client of the analyst's employer. In addition, two directors of the company are senior officers of Jamison's employer. Both facts establish that there are conflicts of interest that must be disclosed by Jamison in her research report. Answer B is incorrect because an analyst is not prevented from writing a report simply because of the special relationship the analyst's employer has with the company as long as that relationship is disclosed. Answer A is incorrect because whether or not Jamison expresses any opinions in the report is irrelevant to her duty to disclose a conflict of interest. Not expressing opinions does not relieve the analyst of the responsibility to disclose the special relationships between the two companies.

4 The correct answer is C. This question asks about compliance procedures relating to personal investments of members and candidates. The statement in answer C clearly conflicts with the recommended procedures in the *Standards of Practice Handbook*. Employers should compare personal transactions of employees with those of clients on a regular basis regardless of the existence of a requirement by any regulatory organization. Such comparisons ensure that employees' personal trades do not conflict with their duty to their clients, and the comparisons can be conducted in a confidential manner. The statement in answer A does not conflict with the procedures in the *Handbook*. Disclosure of such policies will give full information to clients regarding potential conflicts of interest on the part of those entrusted to manage their money. Answer B is incorrect because firms are encouraged to establish policies whereby employees clear their personal holdings and transactions with their employers.

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5 The correct answer is B. This question relates to Standard III(A)–Loyalty, Prudence, and Care and Standard III(E)–Preservation of Confidentiality. In this case, the member manages funds of a private endowment. Clients, who are, in this case, the trustees of the fund, must place some trust in members and candidates. Bronson cannot disclose confidential financial information to anyone without the permission of the fund, regardless of whether the disclosure may benefit the fund. Therefore, answer A is incorrect. Answer C is incorrect because Bronson must notify the fund and obtain the fund's permission before publicizing the information.

6 The correct answer is B. This question relates to Standard V(A)–Diligence and Reasonable Basis. The opinion of another financial analyst is not an adequate basis for Willier's action in changing the recommendation. Answer C is thus incorrect. So is answer A because, although it is true that members and candidates must distinguish between facts and opinions in recommendations, the question does not illustrate a violation of that nature. If the opinion overheard by Willier had sparked him to conduct additional research and investigation that justified a change of opinion, then a changed recommendation would be appropriate.

7 The correct answer is B. This question relates to Standard I(B)–Independence and Objectivity. When asked to change a recommendation on a company stock to gain business for the firm, the head of the brokerage unit must refuse in order to maintain his independence and objectivity in making recommendations. He must not yield to pressure by the firm's investment banking department. To avoid the appearance of a conflict of interest, the firm should discontinue issuing recommendations about the company. Answer A is incorrect; changing the recommendation in any manner that is contrary to the analyst's opinion violates the duty to maintain independence and objectivity. Answer C is incorrect because merely assigning a new analyst to decide whether the stock deserves a higher rating will not address the conflict of interest.

8 The correct answer is A. Standard VII(B)–Reference to CFA Institute, the CFA Designation, and the CFA Program is the subject of this question. The reference on Albert's business card implies that there is a "CFA Level II" designation; Tye merely indicates in promotional material that he is participating in the CFA Program and has completed Levels I and II. Candidates may not imply that there is some sort of partial designation earned after passing a level of the CFA exam. Therefore, Albert has violated Standard VII(B). Candidates may communicate that they are participating in the CFA Program, however, and may state the levels that they have completed. Therefore, Tye has not violated Standard VII(B).

9 The correct answer is B. This question relates to Standard V(B)–Communication with Clients and Prospective Clients. Scott has issued a research report stating that he expects the price of Walkton Industries stock to rise by US$8 a share "because the dividend will increase" by US$1.50 per share. He has made this statement knowing that the dividend will increase only if Congress enacts certain legislation, an uncertain prospect. By stating that the dividend will increase, Scott failed to separate fact from opinion.

The information regarding passage of legislation is not material nonpublic information because it is conjecture, and the question does not state whether the US representative gave Scott her opinion on the passage of the legislation in confidence. She could have been offering this opinion to anyone who asked. Therefore, statement A is incorrect. It may be acceptable to base a recommendation, in part, on an expectation of future events, even though they may be uncertain. Therefore, answer C is incorrect.

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10 The correct answer is C. This question, which relates to Standard III(B)–Fair Dealing, tests the knowledge of the procedures that will assist members and candidates in treating clients fairly when making investment recommendations. The step listed in C will help ensure the fair treatment of clients. Answer A may have negative effects on the fair treatment of clients. The more people who know about a pending change, the greater the chance that someone will inform some clients before the information's release. The firm should establish policies that limit the number of people who are aware in advance that a recommendation is to be disseminated. Answer B, distributing recommendations to institutional clients before distributing them to individual accounts, discriminates among clients on the basis of size and class of assets and is a violation of Standard III(B).

11 The correct answer is B. This question deals with Standard II(A)–Material Nonpublic Information. The mosaic theory states that an analyst may use material public information and nonmaterial nonpublic information in creating a larger picture than shown by any individual piece of information and the conclusions the analyst reaches become material only after the pieces are assembled. Answers A and C are accurate statements relating to the Code and Standards but do not describe the mosaic theory.

12 The correct answer is C. This question involves Standard IV(B)–Additional Compensation Arrangements. The arrangement described in the question—whereby Jurgen would be compensated beyond the compensation provided by her firm, on the basis of an account's performance—is not a violation of the Standards as long as Jurgen discloses the arrangement in writing to her employer and obtains permission from her employer prior to entering into the arrangement. Answers A and B are incorrect; although the private compensation arrangement could conflict with the interests of other clients and lead to short-term performance pressures, members and candidates may enter into such agreements as long as they have disclosed the arrangements to their employer and obtained permission for the arrangement from their employer.

13 The correct answer is B. This question relates to Standard III(A)–Loyalty, Prudence, and Care—specifically, a member's or candidate's responsibility for voting proxies and the use of client brokerage. According to the facts stated in the question, Farnsworth did not violate Standard III(A). Although the company president asked Farnsworth to vote the shares of the Jones Corporation profit-sharing plan a certain way, Farnsworth investigated the issue and concluded, independently, the best way to vote. Therefore, even though his decision coincided with the wishes of the company president, Farnsworth is not in violation of his responsibility to be loyal and to provide care to his clients. In this case, the participants and the beneficiaries of the profit-sharing plan are the clients, not the company's management. Had Farnsworth not investigated the issue or had he yielded to the president's wishes and voted for a slate of directors that he had determined was not in the best interest of the company, Farnsworth would have violated his responsibilities to the beneficiaries of the plan. In addition, because the brokerage firm provides the lowest commissions and best execution for securities transactions, Farnsworth has met his obligations to the client in using this brokerage firm. It does not matter that the brokerage firm also provides research information that is not useful for the account generating the commission because Farnsworth is not paying extra money of the client's for that information.

14 The correct answer is A. In this question, Brown is providing investment recommendations before making inquiries about the client's financial situation, investment experience, or investment objectives. Brown is thus violating

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Standard III(C)–Suitability. Answers B and C provide examples of information members and candidates should discuss with their clients at the outset of the relationship, but these answers do not constitute a complete list of those factors. Answer A is the best answer.

15 The correct answer is C. This question involves Standard I(C)–Misrepresentation. Statement I is a factual statement that discloses to clients and prospects accurate information about the terms of the investment instrument. Statement II, which guarantees a specific rate of return for a mutual fund, is an opinion stated as a fact and, therefore, violates Standard I(C). If statement II were rephrased to include a qualifying statement, such as "in my opinion, investors may earn . . . ," it would not be in violation of the Standards.

16 The correct answer is A. This question involves three of the Standards. Anderb, the portfolio manager, has been obtaining more favorable prices for her personal securities transactions than she gets for her clients, which is a breach of Standard III(A)–Loyalty, Prudence, and Care. In addition, she violated Standard I(D)–Misconduct by failing to adhere to company policy and by hiding her personal transactions from her firm. Anderb's supervisor, Bates, violated Standard IV(C)–Responsibilities of Supervisors; although the company had requirements for reporting personal trading, Bates failed to adequately enforce those requirements. Answer B does not represent a violation because Standard VI(B)–Priority of Transactions requires that personal trading in a security be conducted after the trading in that security of clients and the employer. The Code and Standards do not prohibit owning such investments, although firms may establish policies that limit the investment opportunities of members and candidates. Answer C does not represent a violation because the Code and Standards do not contain a prohibition against employees using the same broker for their personal accounts that they use for their client accounts. This arrangement should be disclosed to the employer so that the employer may determine whether a conflict of interest exists.

17 The correct answer is A because this question relates to Standard I(A)–Knowledge of the Law—specifically, global application of the Code and Standards. Members and candidates who practice in multiple jurisdictions may be subject to various securities laws and regulations. If applicable law is more strict than the requirements of the Code and Standards, members and candidates must adhere to applicable law; otherwise, members and candidates must adhere to the Code and Standards. Therefore, answer A is correct. Answer B is incorrect because members and candidates must adhere to the higher standard set by the Code and Standards if local applicable law is less strict. Answer C is incorrect because when no applicable law exists, members and candidates are required to adhere to the Code and Standards, and the Code and Standards prohibit the use of material nonpublic information.

18 The correct answer is B. The best course of action under Standard I(B)–Independence and Objectivity is to avoid a conflict of interest whenever possible. Therefore, for Ward to pay for all his expenses is the correct answer. Answer C details a course of action in which the conflict would be disclosed, but the solution is not as appropriate as avoiding the conflict of interest. Answer A would not be the best course because it would not remove the appearance of a conflict of interest; even though the report would not be affected by the reimbursement of expenses, it could appear to be.

19 The correct answer is B. Under Standard IV(A)–Loyalty, members and candidates may undertake independent practice that may result in compensation or other benefit in competition with their employer as long as they obtain consent from their employer. Answer C is not consistent with the Standards because

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the Standards allow members and candidates to make arrangements or preparations to go into competitive business as long as those arrangements do not interfere with their duty to their current employer. Answer A is not consistent with the Standards because the Standards do not include a complete prohibition against undertaking independent practice.

20 The correct answer is B. This question involves Standard VI(A)–Disclosure of Conflicts—specifically, the holdings of an analyst's employer in company stock. Answers A and C do not describe conflicts of interest that Smith would have to disclose. Answer A describes the use of a firm's products, which would not be a required disclosure. In answer C, the relationship between the analyst and the company through a relative is so tangential that it does not create a conflict of interest necessitating disclosure.

21 The correct answer is C. This question relates to Standard I(C)–Misrepresentation. Although Michelieu's statement about the total return of his clients' accounts on average may be technically true, it is misleading because the majority of the gain resulted from one client's large position taken against Michelieu's advice. Therefore, this statement misrepresents the investment performance the member is responsible for. He has not taken steps to present a fair, accurate, and complete presentation of performance. Answer B is thus incorrect. Answer A is incorrect because although Michelieu is not guaranteeing future results, his words are still a misrepresentation of his performance history.

22 The correct answer is B. The best policy to prevent violation of Standard II(A)–Material Nonpublic Information is the establishment of firewalls in a firm to prevent exchange of insider information. The physical and informational barrier of a firewall between the investment banking department and the brokerage operation prevents the investment banking department from providing information to analysts on the brokerage side who may be writing recommendations on a company stock. Prohibiting recommendations of the stock of companies that are clients of the investment banking department is an alternative, but answer A states that this prohibition would be permanent, which is not the best answer. Once an offering is complete and the material nonpublic information obtained by the investment banking department becomes public, resuming publishing recommendations on the stock is not a violation of the Code and Standards because the information of the investment banking department no longer gives the brokerage operation an advantage in writing the report. Answer C is incorrect because no exchange of information should be occurring between the investment banking department and the brokerage operation, so monitoring of such exchanges is not an effective compliance procedure for preventing the use of material nonpublic information.

23 The correct answer is B. Under Standard III(A)–Loyalty, Prudence, and Care, members and candidates who manage a company's pension fund owe these duties to the participants and beneficiaries of the pension plan, not the management of the company or the company's shareholders.

24 The correct answer is B. Answer B gives one of the two primary reasons listed in the *Handbook* for disclosing referral fees to clients under Standard VI(C)–Referral Fees. (The other is to allow clients and employers to evaluate the full cost of the services.) Answer A is incorrect because Standard VI(C) does not require members or candidates to discount their fees when they receive referral fees. Answer C is inconsistent with Standard VI(C) because disclosure of referral fees, to be effective, should be made to prospective clients before entering into a formal client relationship with them.

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25 The correct answer is B. Standard VI(B)–Priority of Transactions does not limit transactions of company employees that differ from current recommendations as long as the sale does not disadvantage current clients. Thus, answer A is incorrect. Answer C is incorrect because the Standard does not require the matching of personal and client trades.

26 Answer C is correct. Standard IV(A)–Loyalty discusses activities permissible to members and candidates when they are leaving their current employer; soliciting clients is strictly prohibited. Thus, answer A is inconsistent with the Code and Standards even with the required disclosure. Answer B is incorrect because the offer does not directly violate the Code and Standards. There may be out-of-work members and candidates who can arrange the necessary commitments without violating the Code and Standards.

27 Answer A is correct. The question relates to Standard III(A)–Loyalty, Prudence, and Care. Carter believes the broker offers effective execution at a fee that is comparable with those of other brokers, so he is free to use the broker for all accounts. Answer B is incorrect because the accounts that prohibit soft dollar arrangements do not want to fund the purchase of research by Carter. The new trading scheme does not incur additional commissions from clients, so it would not go against the prohibitions. Answer C is incorrect because Carter should not incur unnecessary or excessive "churning" of the portfolios (excessive trading) for the purpose of meeting the brokerage commitments of soft dollar arrangements.

28 Answer B is correct according to Standard VII(B)–Reference to CFA Institute, the CFA Designation, and the CFA Program. CFA Program candidates do not receive their actual scores on the exam. Topic and subtopic results are grouped into three broad categories, and the exam is graded only as "pass" or "fail." Although a candidate may have achieved a topical score of "above 70%," she or he cannot factually state that she or he received the highest possible score because that information is not reported. Thus, answer C is incorrect. Answer A is incorrect as long as the member or candidate actually completed the exams consecutively. Standard VII(B) does not prohibit the communication of factual information about completing the CFA Program in three consecutive years.

29 Answer C is correct. According to Standard III(A)–Loyalty, Prudence, and Care, the CFA Program would be considered a personal or firm expense and should not be paid for with the fund's brokerage commissions. Soft dollar accounts should be used only to purchase research services that directly assist the investment manager in the investment decision-making process, not to assist the management of the firm or to further education. Thus, answer A is incorrect. Answer B is incorrect because the reasonableness of how the money is used is not an issue; the issue is that educational expense is not research.

30 Answer A is correct. Standard I(B)–Independence and Objectivity emphasizes the need for members and candidates to maintain their independence and objectivity. Best practices dictate that firms adopt a strict policy not to accept compensation for travel arrangements. At times, however, accepting paid travel would not compromise one's independence and objectivity. Answers B and C are incorrect because the added benefits—free conference admission for additional staff members and an exclusive golf retreat for the speaker—could be viewed as inducements related to the firm's working arrangements and not solely related to the speaking engagement. Should Long wish to bring other team members or participate in the golf outing, he or his firm should be responsible for the associated fees.

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31 Answer C is correct. The guidance to Standard II(A)–Material Nonpublic Information recommends adding securities to the firm's restricted list when the firm has or may have material nonpublic information. By adding these securities to this list, Andrews would uphold this standard. Because waiting until the next day will not ensure that news of the merger is made public, answer A is incorrect. Negotiations may take much longer between the two companies, and the merger may never happen. Andrews must wait until the information is disseminated to the market before he trades on that information. Answer B is incorrect because Andrews should not disclose the information to other managers; no trading is allowed on material nonpublic information.

32 Answer B is correct. Through placing a personal purchase order that is significantly greater than the average volume, Pietro is violating Standard IIB–Market Manipulation. He is attempting to manipulate an increase in the share price and thus bring a buyer to the negotiating table. The news of a possible merger and confirmation of the firm's earnings guidance may also have positive effects on the price of Local Bank, but Pietro's actions in instructing the release of the information does not represent a violation through market manipulation. Announcements of this nature are common and practical to keep investors informed. Thus, answers A and C are incorrect.

33 Answer C is correct. Cupp violated Standard III(D)–Performance Presentations when he deviated from the firm's stated policies solely to capture the gain from the holding being acquired. Answer A is incorrect because the firm does not claim GIPS compliance and the GIPS standards require external cash flows to be treated in a consistent manner with the firm's documented policies. Answer B is incorrect because the firm does not state that it is updating its composite policies. If such a change were to occur, all cash flows for the month would have to be reviewed to ensure their consistent treatment under the new policy.

34 Answer A is correct. According to Standard V(C)–Record Retention, Cannan needed the permission of her employer to maintain the files at home after her employment ended. Without that permission, she should have deleted the files. All files created as part of a member's or candidate's professional activity are the property of the firm, even those created outside normal work hours. Thus, answer B is incorrect. Answer C is incorrect because the Code and Standards do not prohibit using one's personal computer to complete work for one's employer.

35 Answer B is correct. According to Standard VII(B)–Reference to CFA Institute, the CFA Designation, and the CFA Program, Quinn cannot claim to have finished the CFA Program or be eligible for the CFA charter until he officially learns that he has passed the Level III exam. Until the results for the most recent exam are released, those who sat for the exam should continue to refer to themselves as "candidates." Thus, answer C is incorrect. Answer A is incorrect because members and candidates may discuss areas of practice in which they believe the CFA Program improved their personal skills.

36 Answer A is correct. Hart's decision to invest in the retail fund appears directly correlated with Rodriguez's statement about the successful quarter of Mega Retail and thus violates Standard II(A)–Material Nonpublic Information. Rodriguez's information would be considered material because it would influence the share price of Mega Retail and probably influence the price of the entire exchange-traded retail fund. Thus, answer B is incorrect. Answer C is also incorrect because Rodriguez shared information that was both material and nonpublic. Company officers regularly have such knowledge about their firms, which is not a violation. The sharing of such information, however, even in a conversation between friends, does violate Standard II(A).

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37 Answer C is correct. Standard VII(A)–Conduct as Members and Candidates in the CFA Program prohibits providing information to candidates or the public that is considered confidential to the CFA Program. In revealing that questions related to the analysis of inventories and analysis of taxes were on the exam, Park has violated this standard. Answer B is incorrect because the guidance for the standard explicitly acknowledges that members and candidates are allowed to offer their opinions about the CFA Program. Answer A is incorrect because candidates are not prohibited from using outside resources.

38 Answer B is correct. Paper has violated Standard III(D)–Performance Presentation by not disclosing that he was part of a team of managers that achieved the results shown. If he had also included the return of the portion he directly managed, he would not have violated the standard. Thus, answer A is incorrect. Answer C is incorrect because Paper received written permission from his prior employer to include the results.

39 Answer A is correct. Townsend has not provided any information about her clients to the leaders or managers of the golf program; thus, she has not violated Standard III(E)–Preservation of Confidentiality. Providing contact information about her clients for a direct-mail solicitation would have been a violation. Answer B is incorrect because the notice in the newsletter does not violate Standard III(E). Answer C is incorrect because the golf program's fund-raising campaign had already begun, so discussing the opportunity to donate was appropriate.

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PRACTICE PROBLEMS

1 An investment management firm that does not adopt the GIPS standards could mischaracterize its overall performance by presenting a performance history:

  A that includes terminated portfolios.

  B composed of a single top-performing portfolio.

  C for an investment mandate over all periods since the firm's inception.

2 Which of the following statements regarding GIPS compliance is correct?

  A Plan sponsors and consultants that manage assets can claim compliance with GIPS.

  B Software that calculates performance in a manner consistent with the GIPS standards can claim compliance with GIPS.

  C Investment management firms can comply with GIPS requirements by limiting their compliance claims to the standards they have chosen to follow.

3 Each composite of a GIPS-compliant firm must consist of:

  A multiple portfolios.

  B portfolios selected on an *ex post* basis.

  C portfolios managed according to a similar investment strategy.

4 Verification of a firm's claim of compliance with the GIPS standards is performed:

  A by firm personnel.

  B on a firm-wide basis.

  C to ensure the accuracy of a specific composite presentation.

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SOLUTIONS

1 B is correct. Selecting a top-performing portfolio to represent a firm's overall investment results for a specific mandate, also known as using representative accounts, is a misleading practice that is not allowed under the GIPS standards. A is incorrect because including terminated portfolios is consistent with the GIPS standards. If the firm instead presented a performance history that excludes terminated portfolios, however, such a practice would be misleading and not allowed under the GIPS standards. C is incorrect because presenting performance for its mandate covering all periods since the firm's inception is consistent with the GIPS standards. If the firm instead presented performance for a selected period during which it produced excellent returns or outperformed its benchmark, however, such a practice would be misleading and not allowed under the GIPS standards.

2 A is correct. Plan sponsors and consultants can make a claim of compliance if they actually manage assets for which they are making a claim of compliance. B is incorrect because software (and the vendors that supply software) cannot be GIPS compliant. Software can assist firms in achieving compliance with the GIPS standards, but only an investment management firm can claim compliance. C is incorrect because a firm has only two options regarding compliance with the GIPS standards: fully comply with all requirements of the GIPS standards and claim compliance through the use of the GIPS Compliance Statement; or not comply with all requirements of the GIPS standards and not claim compliance with, or make any reference to, the GIPS standards.

3 C is correct. A composite is an aggregation of one or more portfolios managed according to a similar investment mandate, objective, or strategy. For example, if a GIPS-compliant firm presents performance for a global equity composite (the composite), the composite must include portfolios that are managed, or have historically been managed, according to the firm's global equity strategy. A is incorrect because a composite is an aggregation of one or more portfolios managed according to a similar investment mandate, objective, or strategy. A composite may consist of a single portfolio when it is the only portfolio managed according to a particular mandate. B is incorrect because the determination of which portfolio(s) to include in a composite should be done according to pre-established criteria (*ex ante* basis), not after the fact (*ex post* basis).

4 B is correct. Verification is performed with respect to an entire firm, not on specific composites.

PRACTICE PROBLEMS

1 With respect to the Global Investment Performance Standards, which of the following is one of the nine sections containing investment performance provisions?

   A Real Estate.

   B Derivatives.

   C Legal and Ethical Considerations.

2 According to the Fundamentals of Compliance section of the Global Investment Performance Standards, issues that a firm must consider when claiming compliance include all of the following *except*:

   A replicating performance.

   B properly defining the firm.

   C documenting firm policies and procedures used in establishing and maintaining compliance with the Standards.

3 G&F Advisors claims compliance with the Global Investment Performance Standards (GIPS) in its marketing materials. The compliant presentation includes a footnote which indicates that the firm has been verified by an independent third party. An additional note states that G&F is in compliance with the GIPS standards except for its private equity investments. Is it *likely* that G&F violated the GIPS standards?

   A No, because the footnotes meet the requirements of the Standards.

   B No, because the provisions do not apply to the private equity investments.

   C Yes, because they cannot claim compliance unless all requirements of the Standard are met.

4 The GIPS standards are instrumental in:

   A enabling regulatory enforcement of investment performance reporting.

   B establishing best practices for calculating and presenting investment performance.

   C eliminating barriers to entry in markets with no investment performance standards.

5 A key feature of the GIPS standards is that:

   A they strive to cover the unique characteristics of each asset class.

   B firms must adhere to all requirements of the standards to claim compliance.

   C actual, discretionary, fee-paying portfolios may be excluded from a composite under limited conditions.

6 What is the minimum period of compliant performance that a 12-year-old firm must present to comply with the GIPS standards?

   A Five years

   B Ten years

   C Twelve years

7 To claim compliance with the GIPS standards, a firm is required to:

   A adhere to certain calculation methodologies.

   B conduct an independent third-party verification of its claim of compliance.

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C perform periodic internal compliance checks of its investment performance process.

8 Adherence to the GIPS standards is reinforced by:

A the sanctioning authority of sponsoring organizations.

B the higher priority placed on compliance with GIPS over conflicting regulations.

C a strong commitment to ethical integrity in fair representation and full disclosure.

9 Which of the following statements concerning the requirements of GIPS Fundamentals of Compliance is correct?

A Firms claiming compliance have full discretion over the dissemination of their compliant presentation.

B Firms may claim partial compliance with the standards provided the performance presented is not false or misleading.

C The definition of the firm creates defined boundaries whereby total firm assets and the basis for firm-wide compliance are determined.

10 According to the Fundamentals of Compliance—Requirements section of the GIPS standards, a firm must:

A include in total firm assets those assigned to a sub-advisor selected by the firm.

B alter historical composite performance after a significant change in the firm's organization occurs.

C represent that the calculation methodology used by the firm is "in accordance with the Global Investment Performance Standards" when presenting performance.

11 The Fundamentals of Compliance section of the GIPS standards recommends that firms:

A conduct a verification.

B adopt a limited definition of the firm, regardless of the actual name of the individual investment management company.

C annually provide existing clients with compliant presentations for each composite on the firm's list of composite descriptions.

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SOLUTIONS

1 A is correct. Real Estate is one of the nine sections in the 2010 edition of the GIPS standards. Derivatives and Legal and Ethical Considerations are not sections of the Standards.

2 A is correct. Replication of performance is not included in the Fundaments of Compliance section within the GIPS standards.

3 C is correct. Firms must meet all the requirements set forth in the GIPS standards and cannot claim partial compliance.

4 B is correct. Given the growth in the types and number of financial entities, the globalization of the investment process, and the increased competition among investment management firms, the establishment of GIPS has led to an accepted set of best practices for calculating and presenting investment performance that is readily comparable among investment firms, regardless of geographic location. A is incorrect because the GIPS standards are a voluntary set of best practices that recognize that investment practices, regulation, performance measurement, and reporting of performance vary considerably from country to country. The standards are based on a "self-regulation" model rather than a legally enforceable regulatory model. C is incorrect because the GIPS standards are designed to encourage fair, global competition among investment firms without creating or eliminating market entry barriers. Presenting performance in accordance with the GIPS standards enables firms to compete on an equal footing regardless of geographic location or the stage of development of local market investment reporting practices.

5 B is correct. To claim compliance, firms must comply with all requirements of the GIPS standards, including any updates. Because meeting the objectives of fair representation and full disclosure is likely to require more than adhering to the minimum requirements, firms should also adhere to the recommendations of the standards to achieve best practice. A is incorrect because the GIPS standards do not address every aspect of performance measurement or cover unique aspects of each asset class. The GIPS standards will continue to evolve over time to address additional areas of investment performance. C is incorrect because the GIPS standards require firms to include all actual, discretionary, fee-paying portfolios in at least one composite defined by investment strategy. There are no exceptions to this requirement for portfolios meeting this definition.

6 B is correct. After a firm presents a minimum of 5 years of GIPS-compliant performance, the firm must present an additional year of performance for each year since its inception, building up to a minimum of 10 years of GIPS-compliant performance. Accordingly, a firm in existence for 12 years must present, at a minimum, 10 years of compliant performance to comply with the GIPS standards.

7 A is correct. The GIPS standards require firms to adhere to certain calculation methodologies and to make specific disclosures along with the firm's performance. B is incorrect because firms may choose (but are not required) to have an independent third-party verification to claim compliance with the GIPS standards. Verification is merely a recommendation of the GIPS standards. Being verified is considered best practice. C is incorrect because the GIPS standards strongly encourage (but do not require) firms to perform periodic

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internal compliance checks of their investment performance process. Internal compliance checks do instill confidence in the validity of the performance presented as well as in the claim of compliance.

8 C is correct. Given the voluntary, "self-regulatory" nature of the GIPS standards, adherence to the standards requires firms to be strongly committed to ethical integrity in the reporting of performance that upholds the principles of fair representation and full disclosure. A is incorrect because sponsoring organizations lack the authority to sanction firms that falsely claim compliance with the GIPS standards. Compliance with the standards is voluntary, and firms "self-regulate" their claim of compliance. B is incorrect because where laws or regulations conflict with the GIPS standards, firms are required to comply with the laws and regulations and fully disclose the conflict in the compliant presentation. Complying with regulations takes priority over compliance with GIPS.

9 C is correct. According to Section 0 of the Fundamentals of Compliance, the definition of the firm is the foundation for firm-wide compliance with the GIPS standards and creates defined boundaries whereby total firm assets can be determined. A is incorrect because according to GIPS Provision 0.A.9, to claim compliance with the GIPS standards, firms cannot choose to whom they present a compliant presentation and must make every reasonable effort to provide a compliant presentation to all prospective clients. B is incorrect because according to GIPS Provision 0.A.6, if a firm does not meet all of the requirements of the GIPS standards, it must not represent or make any statements that may indicate partial compliance with the standards.

10 A is correct. According to GIPS Provision 0.A.14, total firm assets must include assets assigned to a sub-advisor provided the firm has discretion over selecting the sub-advisor. B is incorrect because according to GIPS Provision 0.A.15, changes in a firm's organization must not lead to alteration of historical composite performance. C is incorrect because according to GIPS Provision 0.A.7, statements referring to the calculation methodology as being "in accordance", "in compliance", or "consistent" with the Global Investment Performance Standards, or similar statements, are prohibited.

11 A is correct. According to Section 0.B.2 of the Fundamentals of Compliance—Recommendations of the GIPS standards, it is recommended that firms perform an independent, third-party verification of the firm's claim of compliance. B is incorrect because Section 0.B.3 of the Fundamentals of Compliance—Recommendations of the GIPS standards recommends that firms adopt the broadest (rather than limited), most meaningful definition of the firm. The scope of firm definition should include all geographical offices operating under a common brand name regardless of the actual name of the individual investment management company. C is incorrect because Section 0.B.4 of the Fundamentals of Compliance—Recommendations of the GIPS standards recommends that firms annually provide each existing client with a compliant presentation of the composite in which the client's portfolio is included. The standards do not recommend that firms provide compliant presentations for each composite maintained by the firm.